United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

77-6106

ORIGINAL
WITH PROOF
OF SERVICE

To be argued by
MYRON P. GORDON
(30 minutes)

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

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P/S

NATIONAL MUFFLER DEALERS ASSOCIATION, INC.,

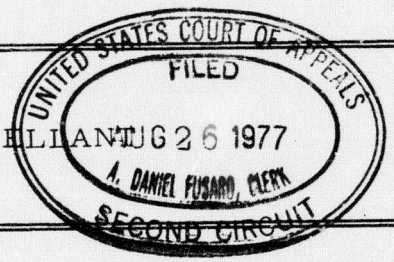
Plaintiff-Appellant,

-against-

UNITED STATES OF AMERICA,

Defendant-Appellee.

ON APPEAL FROM A JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK



BRIEF OF PLAINTIFF-APPELLANT

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INDEX

	Page
Statement of the Case	1
Statutory and Regulatory Provisions Involved	2
Statement of Facts	3
Argument:	
THE DISTRICT COURT ERRED IN DISMISSING THE COMPLAINT AS APPELLANT IS CLEARLY A "BUSINESS LEAGUE" ENTITLED TO THE TAX EXEMPTION CONTEMPLATED BY SECTION 501(c)(6) OF THE INTERNAL REVENUE CODE. SUCH ENTITLEMENT IS NOT DEFEATED BY THE FACT THAT APPELLANT'S MEMBERSHIP IS COMPRISED SOLELY OF FRANCHISEES OF THE SAME FRANCHISOR.....	5
A. It is not necessary that an Association's activities be directed to improvement of business conditions in a "line of business" for the exemption to apply. In any event, Midas dealers are the equivalent of a line of business.....	10
B. There is no requirement that a trade association's activities have a direct benefit to the public in order for it to be entitled to the exemption. In any event, there was unchallenged proof of substantial public benefit from the activities of appellant.....	17
CONCLUSION	27

TABLE OF CASES AND OTHER AUTHORITY

Cases:	Page
Associated Industries of Cleveland, 7 T.C. 149 (1946)	24
Crooks v. Kansas City Hay Dealers' Association, 37 F.2d 83, 85 (8th Cir. 1929)	13, 20, 26
Mercantile Bank & Trust Co. v. U.S., 312 F.Supp. 1164, aff'd. 441 F.2d 364 (8th Cir. 1970)	11
Norton v. Railway Express Agency, Inc., 412 F.2d 112 (3d Cir. 1969)	23
Omaha Live Stock Traders Exchange v. U.S., 244 F.Supp. 384, 387 (Neb. 1965)	13
Pepsi-Cola Bottlers' Association v. United States, 369 F.2d 250 (7th Cir. 1966)	1, 10, 18, 26
Produce Exchange Stock Clearing Ass'n v. Helvering, 71 F.2d 142, 143-44 (2d Cir. 1934)	9, 13, 17-20

Statutes:	
Franchise Investment Protection Act, Wash. S.A., Chapter 252, Sec. 18(2)(b)	8
Franchise Practices Act, N.J.S.A., 56:10-7(b) (Chapter 356)	8
Internal Revenue Code § 501(c)(5)	27
Internal Revenue Code § 501(c)(6)	2, 5

Miscellaneous:	
1966 U.S. Code Cong. & Admin. News 4372,4377-78	19
32 C.J.S., Evidence § 454	24
Webster, The Law of Associations, 15.03(2)(1975)	24
Rev.Rul.61-177,1961-2 Cum.Bull.117	27
Rev.Rul.65-164,1965-1 Cum.Bull.238	27
Treasury Regulation 1.501(c)(6)	2-3, 20

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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NATIONAL MUFFLER DEALERS ASSOCIATION, INC., :

Plaintiff-Appellant, :

-against- :

UNITED STATES OF AMERICA, :

Defendant-Appellee. :

----------x

BRIEF OF PLAINTIFF-APPELLANT

STATEMENT OF THE CASE

Preliminary Statement

This is an appeal from a judgment of the District Court (Southern District, New York), by Hon. Lawrence W. Pierce, dismissing appellant's complaint. The issue in the case - whether a trade association otherwise entitled to tax exemption as a business league (Internal Revenue Code § 501(c)(6)) loses such entitlement because its members are all franchisees of a single franchisor - is one of first impression in this Circuit. That issue has been addressed by only one other Court of Appeals (7th Circuit, 1966) which held, contrary to the holding of the District Court in this case, that the exemption was not lost thereby. Pepsi-Cola Bottlers' Association v. United States, 369 F.2d 250 (7th Cir. 1966).

Plaintiff was organized on January 8, 1971 under the New York Not-For-Profit Corporation Law as a trade association of Midas Muffler franchisees. (A.155). This action is for a tax refund, in which the plaintiff seeks the return of income taxes paid for the

fiscal years 1971, 1972 and 1973. Plaintiff claims entitlement to the refund by virtue of the improper denial by the Internal Revenue Service (IRS) of plaintiff's application for a tax exemption as a "business league" pursuant to Section 501(c)(6) of the Internal Revenue Code ("the Code").

After the appropriate administrative claims were denied by the IRS, appellant filed this action on July 1, 1975. After a trial before the District Court, without jury, the court found that appellant's activities "were not directed to the improvement of business conditions in any 'line of business' within the meaning of the applicable regulation..." and that, therefore, appellant did not qualify for the requested exemption as a "business league." (A. 159) Accordingly, judgment was entered for the defendant dismissing the complaint.

Statutory and Regulatory Provisions Involved

Appellant's application for exemption as a business league was based upon Section 501(c)(6) which provides that the following entities are exempt from federal income taxation:

> "Business leagues, chambers of commerce, real estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players)* not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Treasury Regulation 1.501(c)(6), interpreting this section, reads, in pertinent part, as follows:

* The football league language was not added until 1966. This has been the only change in the Statute since 1913.

> "A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons."

This Regulation was first adopted in 1918 and has not been changed since.

Statement of Facts

As stated above (p. 1), appellant was organized on January 8, 1971 under the New York Not-For-Profit Law as a trade association of franchisees of the Midas International Corp., - "Midas Muffler" dealers. (A.155) Organized initially because of the dealers' fears that an internal struggle within Midas International would affect them adversely (A. 36), the appellant association quickly sought to obtain from the company recognition as a bargaining agent of the franchisees (A. 48), recognition which was later received. (A. 48) The "entire purpose" of the association has been to redress the economic imbalance which is inherent in the franchisor-franchisee relationship. (A. 49)

The association membership is comprised of Midas franchisees with approximately 620 shops, representing 81% or 82% of the Midas shops in the country. (A. 47)

In addition to functioning as a bargaining representative for its members in dealing with their common franchisor, the appellant publishes a newsletter advising members of developments in relations with the franchisor and serving as a forum for the exchange of information and ideas. (A. 44) The Association also

conducts an annual convention which addresses problems common to Midas franchisees. (A. 44)

Among its accomplishments since its inception are: recognition by Midas of its status as a representative of the franchisees (A. 48); the negotiation of a new franchise agreement which, among other things, obtained for the dealers a long term franchise (20 years as opposed to month to month), no cancellation except for specific causes, arbitration and suitable succession provisions (A. 38-39); the introduction of a series of group insurance programs at a reduced cost, and the elimination of a service charge previously imposed by Midas for muffler replacements under Midas' lifetime guarantee, with a resultant cost price saving to the consumer (A. 38-39). The court below recognized these functions and accomplishments of the association (A. 156-157).

The purposes of the plaintiff association, however, are also well articulated in Article I of its By-Laws (A. 184,198):

> "The purposes of this Association are to foster and promote the interests of those individuals, partnerships and corporations who are engaged in business as muffler dealers and installers and related activities, to promote cooperation and mutual interest among its members, to advance the trade and commerce of its members, to encourage the exchange of ideas among its members for their common good and welfare, to secure, classify and disseminate to its members all information essential or helpful in the conduct of their business."

> "The Association shall do anything necessary and proper for the accomplishment of any of the foregoing purposes or any other purpose which may be recognized as a proper and lawful objective of trade associations, all of which shall be consistent with the public interest, as well as in the interest of the members."

Appellant seasonably sought exemption as a business league pursuant to Section 501(c)(6), which exemption was denied. (A. 165)

Having thereafter exhausted its administrative remedies, paid the taxes under protest and complied with all prerequisites to an action for a refund, this action was commenced on July 1, 1975 (see complaint, at A.5). After a trial had before Hon. Lawrence W. Pierce on May 24, 1977, the complaint was dismissed.

ARGUMENT

THE DISTRICT COURT ERRED IN DISMISSING THE COMPLAINT AS APPELLANT IS CLEARLY A "BUSINESS LEAGUE" ENTITLED TO THE TAX EXEMPTION CONTEMPLATED BY SECTION 501(c)(6) OF THE INTERNAL REVENUE CODE. SUCH ENTITLEMENT IS NOT DEFEATED BY THE FACT THAT APPELLANT'S MEMBERSHIP IS COMPRISED SOLELY OF FRANCHISEES OF THE SAME FRANCHISOR.

Section 501(c)(6) of the Internal Revenue Code (IRC) provides an exemption from income taxation for the following entities:

> "Business leagues, chambers of commerce, real estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players)* not organized for profit and not part of the net earnings of which inures to the benefit of any private shareholder or individual."

It needs no elaboration to state that statutes and their supporting regulations must be read in the light of the objects sought to be achieved by Congress. In interpreting legislation, the courts must be vigilant against narrow adherence to specific regulatory language which obviously was never intended to apply to the facts of a case such as this. In this regard, it is imperative to recognize that, enacted in 1913, IRC § 501(c)(6) and the Treasury Regulation subsequently promulgated with respect thereto were both promulgated long before franchising was even known and long before it had appeared as an integral part of the American economy.

* As stated above, the football league language was not added until 1966. The significance of this fact is discussed infra at p.19)

Looking at the statute, it seems clear that the first sentence of Treasury Regulation 1.501(c)(6), in attempting to define a "business league", fairly captures the intent of Congress. Congress sought to grant tax exemption to groups of businessmen "...having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit." In short, we believe that this regulatory language properly embodies Congressional intent. If a group of businessmen form an association to promote their common business interest, they are entitled to the exemption unless the purpose of their joining together is to engage in a regular kind of business for their mutual profit, e.g. a cooperative buying venture. (To be sure, there are two other sentences in the Regulation which we contend do not affect the proper interpreatation of Congressional intent expressed in the first sentence. We discuss this contention at length, infra, at p.10 et seq.) The intent of Congress was clearly to grant tax exemptions to groups of businessmen "having some common business interest" whose primary goal in getting together to accomplish a valid business goal which they could not accomplish alone as opposed to creating a new profit center for their operations.

In view of this clear goal, then, the question which must be asked is does a franchisee association, and particularly the appellant, satisfy this test? Examination of the purposes and accomplishments of those organizations in view of the statutory and regulatory language dictates an affirmative answer to that question.

The advent of franchising on a major scale is a relatively new economic development, fraught with problems for the franchisee which were hardly contemplated when Section 501 was enacted. One of

the by-products of this development has been the highlighting of the tremendous economic inequality between the franchisor and the franchisee. Called to testify on this point was Mr. Gilbert Meisgeir, Executive Director of the National Franchisee Association Coalition (NFAC). (A. 59) NFAC is a coalition of twenty franchisee associations who joined together to support federal legislation directed against abuses of franchisors against franchisees and to act as a clearing-house for information about such abuses. (A. 59-60) Among those abuses Mr. Meisgeir listed "unjust termination, cancellation of franchise agreements, failure to renew without just cause, price fixing, illegal tying arrangements, forced purchases from suppliers selected by the franchisor companies. Things of that nature." (A. 61)

After briefly discussing the genesis of a typical franchising operation, Mr. Meisgeier noted, "As the franchisor's economic might develops they use it against the individual franchisees, and without an association and without the franchisees banding together for their own best interests, everybody would suffer, including the public." (A. 61)

Indeed, the need for associations comprised of franchisees with a common franchisor has been widely recognized in enacted and proposed legislation. A model statute, entitled the Franchise Fair Dealing Act, which has been introduced in a number of states, provides:

> Franchisees shall have the right to association and to select a collective bargaining agent of their own choosing to negotiate and deal with franchisors on matters having to do with their franchise relationship.

Moreover, several states have already passed legislation specifically prohibiting a franchisor from in any manner, directly

or indirectly, interfering with the right of free association among franchisees of any lawful purpose. See, e.g., Franchise Practices Act, N.J.S.A., 56:10-7(b) (Chapter 356); Franchise Investment Protection Act, Wash. S.A., Chapter 252, Sec. 18(2)(b).

What is clear from all this is that the existence and protection of franchisee associations such as the appellant, seeking to establish an economic balance and preclude the franchisors' abuses, is clearly recognized as being necessary for franchisees and being in the public interest. Their existence goes far towards assuring that the economic power of the large, monolithic franchisor is held in check by a countervailing economic force, a valid goal which, quite patently, is clearly something the franchisees could not accomplish without joining together for the purpose. They seek not to profit by these activities, but to protect themselves.

That the appellant fits within this mold was made clear by the testimony of Mr. Gordon who, after relating some of the functions and accomplishments of the association, testified that "the entire purpose of this association has been to redress...an economic imbalance" between Midas and its franchisees. (A. 49)

Thus, the appellant association fits within the statutory language for the exemption* and clearly, too, fits squarely within the intended purposes of Congress in granting the exemption. The District Court, however, found that there were two other prerequisites to the exemption, that the members of the appellant did not meet.

* Mr. Gordon offered the undisputed testimony that the association is "not organized for profit" and that no part of its net earnings inure to any individual (appellant has no shareholders). (A. 53)

The third sentence of the regulation states: "Thus, /the organization's/ activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons." In its conclusions of law, the District Court focused on this sentence and held (A. 9-10):

> 2. To be an exempt business league under Section 501(c)(6) of the Internal Revenue Code, an organization's activities must be '...directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.' Treas. Reg. Section 1.501(c)(6)-1. 'An organization that 'merely serves each member as a convenience or economy in his business' is not a business league. Produce Exchange Stock Clearing Ass'n. v. Helvering, 71 F.2d 142, 143-44 (2d Cir.1934)*
>
> 3. In the case at bar, the applicable industry is the muffler industry, and the applicable 'line of business' is the business of muffler franchisees taken as a whole. Midas Muffler franchisees do not constitute a 'line of business' as that term has been construed by the cases.
>
> 4. Since plaintiff's activities during the year (sic) in question were not 'directed to the improvement of business conditions' in any 'line of business' within the meaning of the applicable regulation, and since the plaintiff's activities rendered no direct benefit to the consuming public, plaintiff was not, during the years in question, a 'business league' within the meaning of Section 501(c)(6) of the Internal Revenue Code.
>
> We believe that these conclusions are not warranted.

*The Produce Exchange case is discussed, infra, at pp. 13, 17-20.

A. It is not necessary that an Association's activities be directed to improvement of business conditions in a "line of business" for the exemption to apply. In any event, Midas dealers are the equivalent of a line of business.

We find considerable difficulty in justifying the denial of a business league exemption to a trade association merely because it is limited to those with common problems. This is the very kind of trade association to which the exemption should logically be granted without question.

Nevertheless, the trial court did just that. We submit that there is nothing in the statute to support the view that Congress intended such a limitation. The statute refers to (1) business leagues, (2) not organized for profit, (3) no part of the net earnings of which inures to the benefit of any private shareholder or individual. No contention can be made that plaintiff fails to satisfy these statutory requirements.

In Pepsi-Cola Bottlers' Association v. United States, 369 F.2d 250 (7th Cir.1966), the plaintiff was comprised of individuals, firms or corporations engaged in the bottling and sale of Pepsi-Cola. The stated purposes of the association were "to improve the trade and business of bottling and selling Pepsi-Cola." 369 F.2d at 250. Similar to the plaintiff herein, the Pepsi-Cola association was formed to assist its members in a cooperative effort "...to solve certain problems common to Pepsi-Cola bottlers, some of whom felt that the Pepsi-Cola Company took no interest in their problems." 369 F.2d at 251. In affirming the District Court's determination that the Pepsi-Cola association was entitled to the

business league exemption, the Seventh Circuit held:

> The plaintiff association cannot be disqualified merely because its members all bottle a particular soft drink product. It is unreasonable to write into the statute and regulations a limitation wholly unsupported by the legislative history.
> 369 F.2d at 252 (emphasis added)*

Secondly, the regulation's definition of a business league is contained in the first sentence thereof: "A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit." Appellant clearly meets each of these requirements as well, its activities constituting virtually a textbook example of adherence to a regulatory definition.

Nonetheless, the District Court has followed the defendant's lead and focused not upon the above-quoted definitive language of the regulation's first sentence, but upon the language of the third sentence which states: "Thus, /the organization's/ activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons." (emphasis added)

Beginning with the word "Thus", it is clear that the third sentence was intended to be merely descriptive of the preceding definitive language. The obvious intention of such language is merely

* The IRS has stated that it will not follow the Pepsi-Cola decision. Rev.Rul.68-142,1968 Cu.Bull.263. It is well recognized, however, that Revenue Rulings are not law and are not in any way binding on the courts. Mercantile Bank & Trust Co. v. U.S., 312 F.Supp. 1164, aff'd. 441 F.2d 364 (8th Cir. 1970).

to distinguish between an organization which seeks generally to improve the conditions of the business in which its members are involved, as does the appellant herein, with one which exists merely to perform particular services for its individual members, which the appellant does not. The District Court's finding has enabled the Government to elevate the descriptive language of the regulation into a restriction which finds no basis in either the statute, the regulation or logic.

The first sentence of the Regulation properly embodies the statute's operative concept that to gain the exemption an association must not engage in "a regular kind of business" for profit. The third sentence is nothing more than an illustration attempting to demonstrate that a group performing services for individual persons would, in effect, be engaging in the prohibited activity, while one whose activities were directed at "improving business conditions in a line of business" would not be. In other words, functioning to help the members profit is bad; functioning to improve business conditions is good. However, focusing upon the "line of business" language so as to make "line of business" a firm prerequisite for the exemption ignores the fact that "business conditions" can be improved for large numbers of franchised businessmen even if together they do not engage in a "line of business."

As earlier stated, in examining the Section 501 exemptions, it is important to ascertain what it was that Congress was attempting to accomplish and a fair appraisal of the statute would indicate that the goal of granting the exemption was to encourage businessmen to join together for the purpose of accomplishing a legitimate business

purpose which they could not accomplish themselves. An individual member of the chamber of commerce, for example, most certainly could not alone create the favorable business atmosphere which the chamber can succeed in creating. An individual employee could not have any effective bargaining power with his employer absent the existence of a union. So, too, an individual Midas franchisee simply could not (and did not) have any effective bargaining power with Midas absent the existence of the appellant association.

This is unlike a cooperative purchasing association or the clearing service association in Produce Exchange, whose activities merely aid their members in doing more efficiently or less expensively that which they could, nonetheless, do themselves. We would not urge that such groups are entitled to exemption as a business league. Appellant's main goal, however, the equalization of the disparate economic power between its members and their franchisor, is a legitimate business goal which goes far beyond the profit motive and which could not in any manner be accomplished by its individual members acting alone. As such, its activities clearly satisfy the goal of Congress in granting tax exemption to "business leagues."

We do not deny that members of the Association are benefited by their membership. This, however, cannot militate against the exemption. As the District Court recognized in granting the exemption in Omaha Live Stock Traders Exchange v. U.S.,244 F.Supp.384,387 (Neb. 1965), "Human experience has taught us that few men would join an organization if they did not derive at least some benefit out of it." And the Eighth Circuit, in granting the exemption in Crooks v. Kansas City Hay Dealers' Association, 37 F.2d 83,85 (8th Cir.1929), properly

recognized that, "it is matter of common knowledge that many boards of trade consist of those who are engaged in similar lines of business; ...to facilitate buying and selling in their own lines." 37 F.2d at 85. In fact, we believe it is safe to say that every member of every organization which has been granted an exemption has joined that organization because he believed it would be to his benefit, financially and otherwise. The exemption, however, is hardly defeated by such motivation.

The economic fact of life which dictates granting the requested exemption is that franchisees of Midas-International share significant problems. Moreover, it is illogical to expect them to join with others in the muffler industry who have no interest in their multifarious problems with Midas. Appellant's very existence is evidence that such problems, common only to Midas franchisees, exist and that, at least in the view of those beset with such problems, there is a need for a collective effort to deal with those problems. Such activity is precisely what was intended by Congress in enacting Section 501(c)(6).

Thus, the exemption should be granted because appellant's activities place it squarely within the statutory requisites and the definitive language of the regulation. The "line of business" language relied upon by the District Court was improperly relied on. Nonetheless, because the Court injected the matter into the case in its denial of the parties' respective summary judgment motions (A.9)*

*The Court found that a factual determination regarding the "share of the /muffler/ market" enjoyed by appellant's members or the "proportion of all muffler franchisees /belonging/ to the plaintiff's association" would be necessary to determine "whether or not plaintiff's activities benefit the muffler industry as a whole." (A.14)

plaintiff did offer some evidence with regard thereto. Though we believe the inquiry to be irrelevant to plaintiff's entitlement to the exemption, we submit that, even if it were relevant, appellant's entitlement is not defeated thereby.

Mr. Robert Kaden is president of Goldring & Company, a market research company located in Chicago, Illinois. (A. 85) In 1975, Goldring & Company conducted a national market study for Midas International, Inc. and the plaintiff association, the primary purpose of which was "to determine the position of Midas in the market on a national scale." (A.108)* After an extensive telephone survey conducted in 18 metropolitan markets in which the company was active (A.109-112,259-60), the study revealed, inter alia, the following:

1. In the period August 1974-75, 29% of car owners in metropolitan areas throughout the country have replaced a muffler.

2. The share of the muffler market held by Midas appears to be increasing; and

3. Midas enjoys a significantly higher brand awareness among those replacing mufflers than does any other brand of muffler.

* Despite the stated goal of the study, and despite Mr. Kaden's 15 years of experience in the field of market research, including frequent interpretation of share-of-the-market data (A.85-87), the Court, though accepting his expertise in the field of market research (A.89) refused to recognize Mr. Kaden as an expert in "share of market studies." (A.102,104) We submit that these determinations are inconsistent on their face, a fact borne out by the Court's ultimate acceptance of the fact that testimony about market research would likely bear on share of the market and its ultimate permission for Mr. Kaden to testify regarding such share of the market. (A.106) The Court's implication that it would give little weight to any such testimony (A.106-7), however, reinstated the error and again served to improperly preclude plaintiff from meeting the burden of proof placed upon it by the Court.

(See "Summary of Findings", Market Study, at A.266-7; also, testimony of Mr. Kaden at A.113 et.seq.)

Based upon the study, Mr. Kaden concluded that Midas "had a unique position in the muffler business" (A.113), had a "strong" image in the eyes of the consumer (A.114) and, in fact, had a dominant position in terms of the national muffler industry. Speaking of that position, Mr. Kaden testified (A.115):

> ...when a company is so well known in a field and so dominant in terms of consumer awareness, they have almost a responsibility on top to the industry. They are so well-known in the industry that they almost become generic to the industry, and what they do to a large extent is emulated and followed when leading from such a strong position, so what Midas does would seem to have influence on what the other factions of the industry also do. (emphasis added)

Speaking of the Midas policy which assures that the price quoted to a customer is the price actually paid (an apparently trend-setting policy in the industry), Mr. Kaden related that he was aware of at least one competitor following the Midas lead and implementing the same policy. (A. 117-18) This is but one example of the effect of the dominance of the Midas name within the muffler industry.

Thus, what is apparent from the testimony of Mr. Kaden is that as the preeminently dominant company in the industry, the influence of the appellant association upon Midas utimately has a major impact upon the entire muffler industry. We respectfully submit that the existence of such a large nationwide chain might well, by itself, be considered a "line of business." Assuming, however, that the "applicable 'line of business' is the business of muffler franchisees taken as a whole" as the Court below concluded (A.159), certainly the position of Midas within that industry makes it clear that appellant's activities are "directed to the improvement of

business conditions /in that line of business/ as distinguished from the performance of particular services for individual persons." (Regulation 1.501(c)(6)).

Thus, assuming, arguendo, that the "line of business" language was intended as a substantive rather than a descriptive provision, a contention which we cannot accept, there is still no basis to withhold the exemption from appellant.

B. There is no requirement that a trade association's activities have a direct benefit to the public in order for it to be entitled to the exemption. In any event, there was unchallenged proof of substantial public benefit from the activities of appellant.

Nothing in the statute or regulation mentions direct public benefit as a prerequisite to the exemption. However, this Court in an earlier case used the following language which the trial court found to be binding upon it:

> Nothing is done to advance the interests of the community or to improve the standards or conditions of a particular trade, as in the case of chambers of commerce, real estate boards, and boards of trade. Under the familiar doctrine of noscitur a sociis, a business league to be exempt must possess the general characteristics of these other organizations with which the statute groups it.
> Produce Exchange Stock Clearing Ass'n v. Helvering, 71 F.2d 142,144 (2d Cir.1934).

When, however, the quoted language is considered in the light of the facts of that case, it becomes apparent that Produce Exchange is not only not a binding precedent but is not even relevant.

That case involved simply an association formed for the purpose of aiding persons trading in securities listed on the Produce Exchange in clearing their transactions. In holding, properly as we believe, that that association was not entitled to an exemption, this Court found that "...petitioner's activities are solely for the direct benefit of its so called 'clearing members' and that such activities were "...simply to provide a business economy or convenience for individual traders". (71 F.2d at 144).

We find no difficulty with this Court's decision in Produce Exchange in view of the seeming fact that the activities of the petitioner therein were apparently aimed solely at increasing the profits of its members through a business economy or convenience. That situation, however, is far different from that which confronts the Court in this case.

As we have already discussed at length (supra, pp.6-9), rather than existing for the purpose of increasing the profits of its members, the appellant association was born out of the necessity of its members to protect themselves against the economic might of their common franchisor. This function is a far cry from that addressed in Produce Exchange and we respectfully suggest that the distinction is such that reliance upon the Court's decision in that case was improper.*

The trial court ignored the factual differences between Produce Exchange and the instant case and, instead, seized upon

* Indeed, in affirming the exemption of the Pepsi-Cola dealers association in 1966, the Seventh Circuit specifically recognized the distinction between the functions of that association (formed for the same basic reason as appellant herein) and the function of the petitioner in Produce Exchange which "did merely provide the convenience of clearing house facilities for a limited group of individual traders in securities." 369 F.2d at 252.

some language in the Produce Exchange opinion as requiring a direct public benefit as a prerequisite to the granting of the exemption.

In Produce Exchange, after finding that the "...petitioner's activities are solely for the direct benefit of its so called 'clearing members'," this Court went on to state:

> Nothing is done to advance the interests of the community or to improve the standards or conditions of a particular trade, as in the case of chambers of commerce, real estate boards and boards of trade. Under the familiar doctrine of noscitur a sociis, a business league to be exempt must possess the general characteristics of these other organizations with which the statute groups it.

Whether or not the language was then a correct statement of the law, it is not now.

Firstly, since the time of the Court's decision, 43 years ago, Congress has added to the organizational grouping in the statute "professional football leagues (whether or not administering a pension fund for football players)." (Amendment, 1966) We question whether any of the other organizations granted an exemption under Section 501(c)(6) possesses many of the "general characteristics of a football league."

Nor is this deficiency cured by the defendant's reliance upon the legislative history of the amendment (Conf. Rep. No. 2308, 89th Cong.,2d Sess., 1966 U.S. Code Cong. & Admin.News 4372,4377-78), which indicates that football leagues were considered "business leagues" even prior to the amendment. (See Defendant's Trial Memorandum, R.20,p.21; See also argument of counsel, A.31-32). The inclusion of the football league exemption, whether it occurred in 1913 or in 1966, seems to place into question this Court's stated belief that organizations exempted by /the predecessor to/ Section

501 are generally granted exemption "because of the benefit to be derived by the public from their activities." 71 F.2d at 143. It is difficult to see the "public benefit" created by football leagues which would justify their classification with chambers of commerce, boards of trade and the like.

As noted earlier, the applicable Treasury Regulation defines a business league as "...an association of persons, having some common interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit." Thus, the express language of neither the statute nor the regulation makes public benefit, much less "direct public benefit", a prerequisite to the business league exemption. We respectfully suggest that, to the extent that this Court's language in Produce Exchange suggests otherwise, it is time to re-examine such language. As the Eighth Circuit properly observed in affirming a business league exemption for an association formed to act as a clearing house of information and to assist those engaged in the hay business in Kansas City, "/The Government/ ... contends that Congress intended to exempt only such organizations as were devoted entirely to the general public welfare. Congress did not so say." Crooks v. Kansas City Hay Dealers' Association, 37 F.2d 83, 84 (8th Cir. 1929) (emphasis added).

Parenthetically, we note further that exemptions are routinely granted to trade associations whose membership consists of either people in different businesses or the same business, in a limited geographical area, joining together for a common business purpose. Certainly the activities of such organizations result in little "public benefit" other than that which Congress apparently

deemed inherent in permitting such common, non-profit oriented joint activity. We urge that the activities of a franchisee association, such as the appellant, clearly provide at least the type of public benefit provided by these other organizations.

Even assuming, however, that a more substantial type of public benefit was a sine qua non for the exemption, the functions and activities of the appellant association are such that entitlement remains clear. Indeed, because the District Judge had specifically injected the issue of public interest into the case (Order Denying Summary Judgment Motion, R.15), the plaintiff made an offer of proof regarding such interest flowing from its activities. Thus, for example, Mr. Gordon testified as to the earlier mentioned elimination of a service charge, with a resultant cost savings to the consumer.* He testified that plaintiff negotiated a significantly lower price for pipes from Midas and a commitment from Midas that the prices therefor will remain competitive. Plaintiff now monitors the pipe prices in the market to assure that prices do remain competitive, all of which activities have resulted in reduced pipe prices to the muffler consumer. (A.40-41)

Apart from these specific, "direct" benefits to the consuming public, the appellant's activities clearly result in what we believe to be even more significant, albeit "indirect" benefits.

* Mr. Gordon was precluded by the Court from testifying that other muffler dealers were forced by Midas's preeminent position in the market to follow suit and eliminate similar charges which they had been imposing on the public. (A.50-53) We urge that such preclusion was error, preventing appellant from demonstrating part of the public benefit which it had been required to show.

Essentially, these consist of creating an economic environment in which the individual entrepreneur is encouraged to enter into business rather than being discouraged by the unequal economic power of the franchisor and, consistent with the underlying philosophy of the antitrust laws of the United States, creating an economic balance which militates against monopolization and resultant abuse of economic power by a large and monolithic franchisor.

As has been several times mentioned herein, the advent of franchising on a major scale is a relatively new economic development in the United States, fraught with problems for the franchisee which were not contemplated when Section 501 was enacted. For example, Mr. Gordon testified that prior to the negotiation of a new franchise agreement by the appellant, the individual Midas franchisee, after having invested a significant amount of money and effort in his franchise, was subject to having that franchise terminated by Midas upon 30 days notice. (A.37) Certainly the negotiation of a new agreement providing for a twenty year term, cancellation only for cause, an arbitration clause in the event of dispute and other benefits (A. 38) went a long way towards encouraging the entrepreneurial efforts of those already in or contemplating entry into the business. Certainly, too, such encouragement of entrepreneurial effort is consistent with the economic public policy of the United States and should be supported.

Moreover, as Mr. Meisgeier's testimony made clear (supra, p. 7), franchisee associations such as the appellant serve to counter the numerous economic abuses frequently perpetrated by the franchisor, such as price fixing, forced purchase from suppliers designated by the franchisor and unjust termination. Appellant's activities are specifically directed to redressing this traditional economic imbalance

on behalf of its members.

As noted earlier, after a brief discussion of the formation of a typical franchising operation, Mr. Meisgeier testified, "As the franchisor's economic might develops they use it against the individual franchisees, and without the franchisees banding together for their own best interests, everybody would suffer, including the public." (A.61)* Mr. Meisgeier cited several specific instances in which the activities of franchisee associations resulted in a direct cost benefit to the consumer (analysis of seasoning formula enabling development of same product at $3 per pound as opposed to franchisor's cost of $24 per pound; new procedures for manufacture and distribution of vehicle replacement parts, theretofore available only through franchisor.) (A.75-76)

Despite a recitation of extensive experience with the franchisor-franchisee relationship and the advantages resulting from the existence of franchisee associations, the District Court refused to declare Mr. Meisgeier an expert witness for the purpose of rendering an opinion regarding the public interest to be served thereby. Nonetheless, the abbreviated factual references made by the witness make clear that such public interest does exist.** We believe that

* Though the Court subsequently refused to declare the witness as an expert able to render an opinion regarding the public interest to be served by the existence of franchisee associations (A.83), a holding we view as error, the quoted testimony was admitted over defendant's relevance objection.

** As stated above we regard this refusal by the Court as error, to which plaintiff duly excepted. (A.83) If experience enables a proferred expert witness to form an opinion which would aid the trier of fact, his testimony should be received, absent some countervailing consideration. Norton v. Railway Express Agency, Inc., 412 F.2d 112 (3d Cir.1969) It is well recognized that "special experience" of a witness may enable him to draw a more accurate inference from

it needs no elaboration to assert that the elimination of the listed abuses, - price fixing, forced purchases from the franchisor, unjust termination, etc., - would inure to the public interest.

It is clear, then, as confirmed by the testimony of Mr. Gordon and Mr. Meisgeier, that the relatively recent advent of franchising on a major scale has brought with it its own set of unique problems affecting both the franchisee and the public. The formation of associations of franchisees who must deal with a common franchisor - their "common business interest" as required in the regulation - is nothing more than the natural outgrowth of this development, just as the formation of labor unions was a direct outgrowth of the common problems faced by employees forced to deal with large employers who were notoriously insensitive to their needs.*

The analogy is an apt one as, much like a labor union dealing with an employer in an attempt to redress the inherent imbalance in bargaining power between them, the plaintiff association performs the identical service for the member franchisee vis-a-vis his dealings

** (continued from p. 23)
particular phenomena than could be drawn by a mere casual observer. 32 C.J.S., Evidence §454. Such is the case with Mr. Meisgeier (See, e.g., A.70). That plaintiff was forced to cut short his testimony was improper and hindered plaintiff from making the public interest showing required by the Court.

* "As of the 'common business interest' requirement, the Tax Court has indicated that it did not have to decide whether association activities actually led to real and permanent improvement of business conditions in one or more lines of business. To qualify, the Tax Court feels it is sufficient that reasonably prudent businessmen think that such activity will improve certain business conditions." Webster, The Law of Associations, 15.03(2)(1975), citing Associated Industries of Cleveland, 7 T.C.1449 (1946).

with the franchisor, Midas. Thus, for example, as Mr. Gordon related, the appellant negotiated a new twenty year franchise agreement obtaining for the franchisees (whether or not members of the association) rights and privileges which they clearly could not have obtained for themselves (A.38,46); the appellant negotiated the aforementioned elimination of the service charge which Midas dealers had theretofore charged to customers holding a Midas guarantee, a change which improved the franchisees' ability to serve the customer in the manner they deemed proper (A.39-40); the plaintiff keeps its members advised of matters of importance to them, both with regard to their businesses and their relationship with Midas, in much the same manner as a labor union does for its members. (A.44) We most strenuously urge that no reason exists to assume that Congress intended to grant to labor organizations a tax exemption (IRC, Sec. 501(c)(5)) while denying it to a franchisee organization whose function is virtually identical.

Defendant urges that the proper source of tax exemption for the franchisee association should be new legislation specifically including such organizations (A.22-23). This view is myopic for two reasons. Firstly, we contend that the term "business league" contains sufficient flexibility to respond to the dynamics of our economy by recognizing the association of franchisees as already properly within its scope. Indeed, we suggest that perhaps Congress, intending the term to have such flexibility, purposely did not restrict it with definitively binding language which might have precluded the grant

of an exemption to an organization such as plaintiff.* No new statute is needed as the exemption for franchisee associations is already contained in the existing law. (See Pepsi-Cola Bottlers' Association v. U.S., op.cit., supra, at p. 16).

The second reason that the Court should not look to Congress is one which is dictated by the realities of the body politic. While it is easy to say, as the Government has, that Congress need only pass a new bill to specifically include organizations such as the plaintiff, anyone familiar with the realities of legislation must recognize that this is easier said than done. Congress is already overburdened with a multitude of issues bearing on the national interest and, absent a full scale, organized lobbying effort it is unlikely that an issue such as tax exemption for franchisee associations is likely to get much attention or rapid action. Especially is this so in view of the fact that an existing statute already carries with it such an exemption under the business league classification and Congress, noting the Pepsi-Cola Bottlers decision, may have regarded new legislation as unnecessary.

The business league exemption has been granted to a number of diverse groups, including, for example: groups of businessmen whose sole common interest was to deal with legislation to improve their competitive standing in the respective businesses in which they

* It is interesting to note that in the Kansas City Hay Merchants case, supra, p. 13, the Eighth Circuit seemed to recognize the broad spectrum of organizations which could be classified as a "business league." In searching for a definition, the Court looked to the definitions of its components: "'Business' is defined in Black's Law Dictionary as follows: 'Business is a very comprehensive term and embraces everything about which a person can be employed,' which definition is approved by the Supreme Court /citation/ ... 'League' is defined in Webster's New International Dictionary as 'an agreement or covenant between two or more nations, parties, or persons for the accomplishment of some purpose by their cooperation.'" 37 F.2d at 85.

were engaged (Rev.Rul.61-177,1961-2 Cum.Bull.117); groups of businessmen with a common interest in dealing with labor unions representing their employees (Rev.Rul.65-164,1965-1 Cum.Bull.238); and groups of employees with a common interest in dealing with their employers (IRC 501(c)(5)). In each such instance, the function of the exempt organization was to perform an activity beneficial to the members which such members could not effectively perform alone. This goal is clearly in the public interest and we submit that equal treatment under the law demands that individual businessmen with a common interest in dealing with their common franchisor are no less entitled to tax-exempt status than any of the aforementioned groups. Certainly it was the intention of Congress, in exempting "business leagues," to assure such equal treatment.

CONCLUSION

The issue to be determined in this case - one of first impression in this Circuit - is whether a nationwide association of franchisees with a common franchisor, joining together to deal with common problems arising from that relationship, is properly entitled to the business league exemption granted by Section 501(c)(6). In view of the continuing and burgeoning development of the franchising concept as a commercial vehicle in our economy, the issue is one which cannot be regarded lightly.

An association such as the appellant goes far towards redressing the inherent economic imbalance of bargaining power between the individual franchisee and its franchisor. By thereby mitigating the traditional vulnerability of the franchisee and precluding some

of the more egregious abuses perpetrated by the franchisor, the association encourages other individual entrepreneurs to make investments, in the best tradition of American capitalism. Surely, as the Seventh Circuit recognized, the term "business league" contains sufficient flexibility to respond to the dynamics of our economy by encompassing the franchisee association as properly within its scope. The defendant's reliance upon limited concepts of "public interest" and "line of business", adopted by the District Court, should not serve to obviate the clear intention of Congress to grant the exemption to groups such as the appellant.

For the reasons set forth in the brief, the denial of appellant's application for a tax exemption should be set aside and the exemption granted.

Respectfully submitted,

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STATE OF NEW YORK)
COUNTY OF NEW YORK) ss .

JAMES LEVERICH, being duly sworn, deposes and says that deponent is not a party to the action, is over 18 years of age and resides at 185 ST MARKS PL. STATEN ISLAND, N.Y.

That on the 26 day of AUGUST, 1977, deponent personally served the within BRIEF OF PLAINTIFF-APPELLANT upon the attorneys designated below who represent the indicated parties in this action and at the addresses below stated which are those that have been designated by said attorneys for that purpose.

By leaving 2 true copies of same with a duly authorized person at their designated office.

~~By depositing _____ true copies of same enclosed in a postpaid properly addressed wrapper, in the post office or official depository under the exclusive care and custody of the United States post office department within the State of New York.~~

Names of attorneys served, together with the names of the clients represented and the attorneys' designated addresses

ROBERT B. FISKE, JR. ESQ
U.S. ATTORNEY OF THE SOUTHERN DISTRICT OF N.Y.
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James Leverich

Sworn to before me this
26 day of August, 1977

Michael DeSantis

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0330909
Qualified in Queens County
Commission Expires March 30, 1979